STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

ILLINOIS POWER COMPANY	)	
	)	04-0476
Proposed General Increase	)	
in Natural Gas Rates	)	

REPLY BRIEF OF BUSINESS ENERGY ALLIANCE AND RESOURCES, L.L.C.

Stephen J. Moore
Rowland & Moore LLP
200 W. Superior Street
Suite 400
Chicago, Illinois 60610
(312) 803-1000
steve@telecomreg.com

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REPLY BRIEF OF BUSINESS ENERGY ALLIANCE AND RESOURCES, L.L.C.

I. Introduction

In its initial brief, Business Energy Alliance and Resources, LLC ("BEAR") demonstrated that grain dryers, which will take service under SC 66, are being asked to absorb a rate increase larger than the rate increase being imposed on other classes. Given the settlement of issues in this proceeding, grain dryers were not certain exactly how large that increase would be relative to other classes. Now that IP has filed updated figures in its Initial Brief reflecting settled revenue requirement and rate design issues, grain dryers can see that, they are being asked to share a larger portion of IP's rate increase in their base rates than all other rate classes.

IP's chart on page 76 of its brief shows the post settlement revenue requirement allocation and revenue increase for each class if the company is granted its full requested rate increase. In order to provide a better understanding of the impact of IP's proposed rate increase and revenue allocation, BEAR has added the percentages to IP's chart.

Class	**Constrained Revenue Requirement Allocation**	**Revenue Increase Allocation**	**% Increase**
SC 51 (Residential	$ 94,367,237	$ 5,272,995	5.9%
SC 63 (Small Volume Firm)	$ 24,961,155	$ 4,951,857	24.7%
SC 64 (Intermediate Volume Firm)	$ 5,792,893	$ 1,590,135	37.8%
SC 66 (Seasonal)	$ 1,140,930	$ 536,190[1]	88.7%
SC 65/76 (Industrial)	$ 9,886,510	$ 1,875,747	23.4%
SC 90 (Contract)	$ 1,240,878	--	--
Totals	$137,389,604	$14,226,923	11.6%

[1] IP has argued that the increase in rates for SC 66 should be offset by a decrease in their PGA proposed by the company. While that decrease offsets the net impact on some grain dryers (those who purchase gas from IP), it does not change the inequity of the allocation of base rates among classes. Nor does it help grain dryers purchasing gas from other sources.

Those figures should astonish this Commission. The 88.7% increase for SC 66 is actually much larger for smaller grain dryers because the high facilities charges IP proposed for SC 66 will have the largest impact on the customers with the smallest use. How can IP justify an 88.7% rate increase for grain dryers? SC 66 is a class that the company admits provides a benefit to the company and all classes by using gas in non-peak months and thus providing revenue with little need for peak day investment. Yet SC 66 is being asked to absorb a rate increase almost eight times the system average increase and more than double the increase faced by any other class. As demonstrated in BEAR's initial brief, IP has accomplished this feat by "adjusting" its cost of service study in numerous ways to the detriment of SC 66. This Commission should reject IP's manipulation of its cost study and direct the company to recalculate revenue allocation consistent with the recommendations made by BEAR in its Initial Brief.

II. IP's Cost of Service Study Does Not Allocate Demand Charges Appropriately.

First, the Company is trying to confuse the issue with regard to its adoption of the Average and Peak ("A&P") method, as requested by Staff. The Company states several times that it is employing the A&P with the modification that it is excluding the peak demands of grain drying and asphalt customers from the calculation. IP Brief at 64-65. However, the grain drying and asphalt customers **have no** coincident peak demand, and the A&P method should utilize coincident peak demands. Staff supports this concept in its brief, stating "…distribution investment is driven by the need to meet demands when the system as a whole, rather than individual rate classes, reaches its peak." (Brief p. 54) The Company is merely calculating the

Peak portion of the A&P method correctly. It is not adjusting the Peak portion of the method. This issue is discussed later in connection with Staff testimony.

IP's error in this case is its decision to depart from the A&P method when calculating the Average component for SC 66. In its direct testimony, IP calculated of the Average component of the A&E method by dividing the total annual use of a class by 365 days. That formula was used for all customers, including grain dryers and asphalt manufacturers. In its rebuttal testimony, IP accepted the Staff's request that it use the A&P method. IP then used the same calculation of the Average component for most customer classes that it had used in the A&E method – total annual use divided by 365 days. For grain dryers and asphalt manufacturers, however, IP divided total annual use by 61 days and 184 days respectively. Put another way, IP's adjustment to the A&P method treats grain dryers as if their total annual use is six times larger than actual use. Ms. Smith characterized this revision to the A&P method as "using a measure that is more like non-coincident peak than average use." BEAR Ex. 1 at 5. In fact, one would expect that the changing from the A&E method to the A&P method should lower the allocation of transmission and distribution costs to SC 66 customers because they have no peak use. Yet IP's adjustment to the A&P method has raised the allocation of both transmission and distribution costs to SC 66 above the allocation it had calculated with the A&E method. IP Brief at 65.

IP has no real defense of its adjustment to the A&P method other than the fact that this adjustment results in the allocation the company would like to see. The company states that 90% of grain dryer and asphalt use occurs during these days and then concludes that it "was appropriate for IP to recognize this cost causation factor in determining the correct allocator. To do otherwise would only serve to inappropriately place more costs on other customers." IP Brief

at 67. What "cost factor" is the company talking about that requires it to pretend that grain dryer annual use is six times larger than actual use? There is no such cost factor to be recovered in the A&P method.

Because grain dryers do not use gas during peak periods, they do not impose peak costs on IP. Therefore, they **should** have a zero in the Peak component of the A&P method. Their average use over the course of the year reflects their total use of the system. There is nothing special about grain dryer use pattern that requires an adjustment to the Average component of the A&P method that raises that component by a factor of six. Because these costs are recovered as a per therm charge, using the unadjusted A&P formula for all customers would result in a grain dryer paying the same amount over 12 months from the Average component of the A&P method as a typical customer with the same average use. The fact that that recovery occurs in September and October does not change the fact that it is fully recovered. In summary, there is no unrecovered "cost factor" that requires an adjustment to the A&P method that increases the Average component of grain dryers rates by a factor of six.

IP argues that by requesting that the average use be calculated by dividing by 365 days, BEAR is asking "recognition….that grain drying and asphalt customers are consuming gas each day of the year…" (Brief p. 67). This is incorrect. BEAR is simply requesting that the average be calculated the same way for SC 66 customers as for all other customers. Few, if any, IP customers use gas constantly each day of the year. Yet IP does not propose to adjust any other customer class average to reflect their uneven usage pattern.

If the results were not so devastating for grain dryers, it would be humorous to read IP's claim that it "applied an empirical, objective analysis in its approach, in contrast to BEAR's approach, which is driven by end results objectives only, and is without any basis in fact." IP

Brief at 68. The reverse is obviously true. BEAR only asks that grain dryers be treated like all other customers in the application of the A&P method and that they pay rates based on their peak use and total annual use. IP's adjustment to the A&P method, on the other hand, is neither empirical nor objective. Rather, it is a massive shifting of demand charges on to grain dryers that is unsupported by logic or evidence.

Finally, IP claims "Staff witness Mr. Lazare accepted IP's rationale when developing his T&D allocators." IP Brief at 68 (citing Staff Ex. 16.0, p. 2). He did no such thing. The statement cited by IP was Mr. Lazare's reply to Ms. Althoff's rebuttal testimony. Ms. Althoff had stated:

> [T]he Company will adopt Staff witness Lazare's proposal to use the A&P method in this case, but with a modification to the peak component. Specifically, peak demand data for grain drying and asphalt customers should be excluded from the calculation, because their peak usage occurs at times other than the peak winter month and tariff provisions in proposed SC 66 encourage customers to avoid use during cold periods. This provision is consistent with a strict application of the A&P method.
> IP Ex. 5.6 at 21.

Nothing in that description of IP's adjustment to the A&P method refers to the Company's unique method of calculating the Average component. Thus, it was entirely appropriate for Mr. Lazare to support the adjustment. Addressing Ms. Althoff's rebuttal testimony, he testified:

> [S]he states that in light of recent Commission decisions on this issue the Company will adopt Staff's proposed A&P approach with one modification. IP proposes to exclude peak demand data for grain dryer and asphalt customers in the proposed SC 66 class from the calculation because they do not use gas during the peak winter month (IP Ex. 5.6, p. 4).
>
> Q. Do you find the Company's proposed revision to Staff's A&P allocator acceptable?
>
> A. Yes. Any customer classes that fail to use gas during the peak day should not be factored into the peak demand component of the A&P allocator.

Staff Ex. 16, p. 2.

In other words, Mr. Lazare agreed that because grain dryer and asphalt customers have zero peak demand, the Peak component of the A&P method should be zero for those customers. The fundamental A&P method, and that which the Commission has supported in other cases, includes an average component that is just that, i.e. annual use divided by 365.

IP has misstated its methodology when it denies that any excess or peak costs were allocated to SC 66. IP Brief at 64-65. In fact, by dividing annual use by 61 instead of 365 it has increased Average component of the A&P method by a factor of six, and therefore implicitly brings the SC 66 non-coincident peak into the average component.

III. IP's Cost of Service Study Mixes Embedded Costs With Current Costs In the Calculation of the Customer Charge.

In its initial brief, BEAR showed that IP's cost of service study inappropriately mixed embedded costs with current costs in the calculation of the customer charge. BEAR Brief at 8-9. IP argues that using current costs provides a better basis for allocating costs because it eliminates the varying impacts inflation on different cost items when historic costs are used, its books and records are maintained in accordance with the Federal Energy Regulatory Commission's Uniform System of Accounts and it uses current costs in its delivery service tariffs. IP Brief at 72.

IP's arguments are irrelevant and entirely miss the point of BEAR's criticism. BEAR agrees it is sometimes appropriate to use current costs. Ms. Smith even noted that current costs often represent a reasonable proxy for embedded costs, <u>if</u> the cost relationship between items remains the same. BEAR Ex. 2 at 7. The problem here is that IP has mixed and matched

historic and current data and has done so for items that do not have the same historic and current cost relationship. To the extent that steel pipe currently costs more relative to plastic pipe than the cost relationship when most pipe was installed, IP is calculating an incorrect service plant allocation. Id. Put another way, IP's rate base reflects its historic investment at historic prices. Those costs should form the basis of the cost allocation, not current costs. Staff supports this position when it states that it is an error to focus solely on current prices. (Staff Brief at 61)

It is important to understand the purpose of allocating existing plant investment. IP has conducted an embedded cost study in which it is attempting to identify the relative amount of dollars that have been invested to serve each class. It is therefore irrelevant that inflation has affected prices for steel pipe more than other items, that IP reports current costs to FERC or that IP uses current costs in its delivery service tariffs. The embedded cost of service study is allocating embedded costs, not the costs that would exist if all customers had new equipment, i.e. purchased at current costs.

IV. SC 66 Customers Should Pay Facilities Charges Comparable to Those Paid by Customers Taking Service Under Comparable Rates.

IP describes the process for dividing SC 66 into three categories to determine the Facilities Charge for the class. According to IP, the company determined the facilities charge for SC 66 customers by grouping them into those who's meters had an installation cost of $8,500 or less, approximately $20,000, and approximately $40,000, and by considering the MAOP and capacity associated with both low pressure and high pressure mains. IP Brief at 88.

While IP's methodology has the gloss of an objective analysis, its result is contrary to cost of service principles. As noted in BEAR's Initial Brief, IP is proposing to raise the level of facilities charges for SC 66 well above the facilities charges for the other classes of service

available to them – SC 63, SC 64 and SC 65. In other words, although IP claims that the facilities charge for all four rate classes are cost based, a SC 66 customer will pay far more than it would pay if it took service under IP's general service rates it is eligible to use. This price difference exists even though the facilities serving a grain dryer will be the same whether it takes service under SC 66 or under the regular firm gas rate appropriate for its demand and usage. Switching rates will not require the installation of any new facilities. See BEAR Initial Brief at 9-11. BEAR therefore continues to make the recommendation it made in its Initial Brief - that the SC 66 customer charge be set the same as the regular firm rate that each customer would be eligible to take service under.

V. The Commission Should Direct IP to Constrain Its Rate Increase to SC 66.

BEAR believes that if IP recalculates its cost of service study consistent with the recommendations of BEAR, the final rate increase assigned to SC 66 should be within reasonable bounds. Nevertheless, regardless of the final revenue allocation, the Commission should ensure that grain dryers not be exposed to a rate increase that is multiples greater than other classes. As shown on the chart at the beginning of this brief, IP's requested rate increase is 10%. Ms. Smith had recommended that the rate increase for grain dryers be subject to the restraint that it be no greater than 50% larger than the system average rate increase. BEAR recognizes that a 15% increase would be smaller than all classes beside SC 51, so that limitation is not practicable. Nevertheless, the concept is one that should be used by this Commission, albeit with a different restraint. BEAR recommends that the Commission limit SC 66 to a percentage increase somewhere in the range of those being given to the rate classes that grain dryers would otherwise be eligible to take service under – SC 63, SC 64 and SC 65.

VI. CONSLUSION

For the reasons given in above and in BEAR's Initial Brief, the Commission should direct IP to make the following changes to its cost of service study and then redesign its rates to reflect the recalculated study:

1. Reallocate capacity costs by calculating the "average" component of the Average and Peak method in a consistent manner for all classes (divide total annual use by 365).
2. Allocate service costs using all historic costs rather than a mixture of historic and current costs.
3. Cap the rate increase for SC 66 so that it is in the range of the percentage increases for SC 63, SC 64 and SC 65.
4. Set the SC 66 customer charges the same as other comparable IP rates (SC 63, SC 64 or SC 65) available to SC 66 customers.

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Respectfully submitted,
Business Energy Alliance and Resources, L.L.C.
*Stephen J. Moore*_____
By: Stephen J. Moore

Stephen J. Moore
Rowland & Moore LLP
200 W. Superior Street
Suite 400
Chicago, Illinois 60610
(312) 803-1000
steve@telecomreg.com

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that he caused copies of the attached Reply Brief of Business Energy Alliance and Resources LLC be served on each of the persons on the attached Service List by e-mail on February 23, 2005.

Stephen J. Moore
Stephen J. Moore
Attorney for Business Energy Alliance
and Resources LLC

Richard C Balough
Atty. for Citizens Utility Board
53 W. Jackson Blvd., Ste. 956
Chicago IL 60604

Thomas M Byrne
Ameren Services Company
1901 Chouteau Ave.
P.O. Box 66149 (MC1310)
St. Louis MO 63166-6149

Janice A Dale
Assistant Attorney General
Public Utilities Bureau
100 W. Randolph St., 11th Fl.
Chicago IL 60601

Ralph E Dennis
Director
Constellation NewEnergy - Gas Division, LLC
9960 Corporate Campus Dr., Ste. 2000
Louisville KY 40223

David I Fein
Senior Counsel
Constellation NewEnergy Group, Inc.
550 W. Washington Blvd., Ste. 300
Chicago IL 60661

Edward C Fitzhenry
Ameren Services Company
PO Box 66149 (M/C 1310)
1901 Chouteau Ave.
St. Louis MO 63166-6149

Carmen Fosco
Illinois Commerce Commission
160 N. LaSalle St., Ste. C-800
Chicago IL 60601-3104

Janis Freetly
Case Manager
Illinois Commerce Commission
527 E. Capitol Ave.
Springfield IL 62701

Mark G Kaminski
Assistant Attorney General
100 W. Randolph St., 11th Fl.
Chicago IL 60601

Robert Kelter
Citizens Utility Board
208 S. LaSalle St., Ste. 1760
Chicago IL 60604

Owen E MacBride
Atty. for Illinois Power Company
Schiff Hardin & Waite
6600 Sears Tower
Chicago IL 60606

Stephen J Moore
Atty. for BEAR
Rowland & Moore LLP
200 W. Superior St., Ste. 400
Chicago IL 60610

Samantha C Norris
Atty. for Illinois Power Company
Schiff Hardin & Waite
6600 Sears Tower
Chicago IL 60606

Katie Papadimitriu
Regulatory Affairs Manager
Constellation NewEnergy, Inc.
550 W. Washington St., Ste. 300
Chicago IL 60661

Eric Robertson
Atty. for IIEC
Lueders, Robertson, Konzen
1939 Delmar Ave.
P.O. Box 735
Granite City IL 62040

Randall Robertson
Atty. for IIEC
Lueders, Robertson, Konzen
1939 Delmar Ave.
P.O. Box 735
Granite City IL 62040

Ryan Robertson
Atty. for IIEC
Lueders Robertson & Konzen
PO Box 735
1939 Delmar Ave.
Granite City IL 62040

Chris Thomas
Sr. Policy Analyst
Citizens Utility Board
208 S. LaSalle, Ste. 1760
Chicago IL 60604

Janis Von Qualen
Illinois Commerce Commission
527 E. Capitol Ave.
Springfield IL 62701

Shig W Yasunaga
Regulatory Counsel
Illinois Power Company
500 S. 27th St.
Decatur IL 62521

Michael L. Wallace
Administrative Law Judge
Illinois Commerce Commission
527 E. Capitol Avenue
Springfield, IL 62701

Joseph L. Lakshmanan
Dynegy Inc.
2828 North Monroe Street
Decatur, IL 62526